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Property Tax Reform in Vietnam: A Work in Progress

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Property Tax Reform in Vietnam: A Work in Progress

Hong-Loan Trinh and William J. McCluskey

Abstract
In 2012, Vietnam will celebrate 25 years of economic reform and structural re-adjustment from a largely centralized, subsidized economy to one based on market principles. A major component of these reforms has involved establishing land and property rights, thereby giving individuals and organizations secure title to the property they occupy and use. The passing of various Land Laws has given legislative support to the concept of private property rights. This represents a significant ideological change, given that land in Vietnam has always been considered to belong to the State. In conjunction with these changes, focus has shifted to reforming the real property tax from a tax largely based on rice productivity to one based on *ad valorem* principles. This paper reviews existing property-based taxes, highlighting their weaknesses and outlining the potential for a land tax to effectively replace the current property tax.

Key words: Vietnam, land ownership, land tax, property taxes, property tax reform, area-based taxation
JEL codes: H24, Q15

Property Tax Reform in Vietnam: A Work in Progress

1. Introduction

Since the economic and structural reforms known as *doi moi*, Vietnam has made significant progress from a centrally planned state to a market-based economy. The last 25 years have seen comprehensive reforms, especially in land administration and land policy (Ravallion and van de Walle 2008; Schmidt 2004). These reforms, together with an open-door policy to attract foreign direct investment and encourage trade liberalization, culminated in Vietnam's acceptance into the World Trade Organization (WTO) in 2007 (Dapice et al. 2010). The effects of these comprehensive reforms include significant GDP growth, macroeconomic stabilization, export expansion, poverty reduction, and market institution development (Boothroyd and Pham 2000). Between 1990 and 2010, Vietnam's GDP growth rate averaged over 7 percent a year (GSO 2011).

One of the fundamentals of this economic growth has been the restructuring of land use within the country to support economic growth through agricultural and industrial development (Lavigne 2000). As part of its social and economic transformation, Vietnam has experienced extensive urbanization. Between 2000 and 2010, about 895,000 hectares of agricultural land (3.5 percent of total agricultural land) were converted to residential, commercial, and industrial use, public works, and other non-agricultural purposes (MONRE 2011). Vietnam has also started to issue Land Use Right Certificates (LURCs). By 2008, some 10.53 million LURCs had been granted for 413,060 hectares, accounting for approximately one-tenth of the total land area (MONRE 2010).

There is a consensus that clearly identified and secure property rights have a positive effect on economic growth (Kim 2004). In addition, it has been argued that a major constraint to prosperity in developing countries is the inability to convert property into usable and tradable assets because of the lack of transparency in property markets and the ineffectiveness and inefficiency of the institutions that deal with land registration and titling (de Soto 2000; Kim 2004). The proper management and efficient use of land, along with accessible information on its use and status, are central issues for developing countries in maximizing the potential benefits of sustainable socioeconomic, rural, and urban development.

Changes in national economic well-being are reflected in urban development patterns. Vietnam is home to 88 million people, of which 30 percent live in urban areas; however, this number is expected to increase to 45 percent or 46 million people by 2020 (IMF 2011). Vietnam is undergoing one of the fastest urban transitions in the world. Urbanization is recognized as a driving force behind the country's economic growth (Webster 2004). Vietnam's largest cities—Ho Chi Minh City with a population of almost 9 million and an area of 2,095 km^2 and Hanoi with a population of just under 7 million and a land area of 3,3445 km^2 (GSO, 2011)—are playing a fundamental role in the country's transition to a market-oriented economy.

The introduction of market economy reforms in the late 1980s has paved the way for the adoption of export-oriented growth and integration into the global economy. In accordance with most regional transition theories, the metropolises of Ho Chi Minh City and Hanoi have derived the most benefit from the opening up of the economy to global capital. Urban areas serve as the country's engines of growth; Ho Chi Minh City experienced an economic growth rate of 11–12 percent and Hanoi of 10–11 percent between 2001 and 2011 (Hanoi 2011; Ho Chi Minh City 2011). Urban infrastructure expansion, however, has not kept pace with the rate of urbanization. As a result, the cities face problems such as air and water pollution, a lack of housing, and traffic congestion.

The combination of rapid urbanization rates and rising urban incomes is leading to a dramatic increase in effective demand for essential municipal infrastructure and services throughout the country (Nguyen 2009; Quang and Kammeier 2002). This demand is placing considerable strain on scarce financial resources in cities and urban areas, highlighting the urgent need to improve both municipal revenue generation and the efficiency and effectiveness of municipal expenditures. Finding ways to finance investment in infrastructure and basic services in a sustainable and equitable manner is a tremendous challenge facing the cities' policymakers.

One tax with the potential to raise sufficient revenue from fast-developing cities is the property tax (Bahl 2009; Bahl and Martinez-Vaquez 2007). This tax can be viewed as a tax on real estate wealth; within cities like Ho Chi Minh City and Hanoi there is a considerable store of wealth attached to real property (Deininger and Songqing 2003; Kato 2010). It is also clear that government-funded infrastructural development can have positive effects on property values. It could be argued that by taxing the value of property, the government is able to recoup part of the wealth it has created.

The property tax in various forms exists in most countries (McCluskey 1999). In both principle and practice, this tax can have important fiscal and non-fiscal benefits (Bird and Slack 2004). The revenue that such a tax produces is often of critical importance to local and, in some cases, higher levels of government.

Real property taxes provide a predictable and durable revenue source for local budgets, foster local autonomy, and represent a fiscal mechanism for decentralization (Bird and Bahl 2008). Indeed, few fiscally significant taxes are more susceptible to local administration than the property tax (Bell, 2003; Bird and Slack 2004; Mikesell 2003). The immovability of the tax base makes clear which government is entitled to the tax revenue. The tax also captures some of the increases in the value of land that are partially created by public expenditures. As McCluskey (1999) points out, real property is visible, immobile, and a clear indicator of one form of wealth. The property tax is especially attractive when compared with other potential sources of local taxes (Bird 2011). The property tax is difficult to avoid and can represent a non-distortionary and highly efficient fiscal tool. However, it is essential that the tax be administered in a fair and equitable manner to minimize any distortions and adverse effects such as regressivity.

This paper examines the potential for the introduction of a land-based property tax in Vietnam and in particular how this tax could effectively replace several inefficient taxes on land and property that are currently being used. The objective of this research is to demonstrate the efficacy of introducing a land tax and the revenue potential of such a tax, particularly for Vietnam's largest cities.

The paper is organized into five sections. The section immediately following this introduction outlines the developments in land ownership in Vietnam that have created the necessary administrative and legal infrastructure essential for property tax implementation. A review of existing land-based property taxes and their revenue importance is provided in section 3, and section 4 reviews options for property tax reform. The final section summarizes the findings and draws some conclusions.

2. Land and land ownership in Vietnam

During the past 20 years, Vietnam has passed three successive land laws and amended these laws twice; the current land law was passed in 2003. To meet new economic challenges and foster international integration, the Vietnamese Parliament has been intending to review the current legislation and develop a new land law since 2006.

Within the Vietnamese legal framework, land is regarded as a natural resource, a gift of nature similar to air, water, minerals, and forests. Once accessed, appropriated, and exploited, such a natural resource begins to develop value. Vietnam defines land as invaluable national property under the ownership of the Vietnamese People. However, in the Constitution and Civil Code, land is not only defined as property, but also categorized as a "natural resource." In fact, previous land laws stated that "land is a natural resource." The current land law does not refer to land as either being a natural resource or property; from a legal perspective, this is an important point. Within the territory of a country, land should be regarded as property, not a natural resource, because of the human and financial capital invested to make it useful.

Many countries consider land to be property. In others, even though not defined as property or a natural resource, land is legally regulated as a financial asset. Defining land as a natural resource, as in Vietnam, leads to major problems in dealing simultaneously with public ownership and private user rights.

Several different ministries are involved in the regulation and use of land. The Ministry of Construction is in charge of urbanization, urban planning, and regulations on housing and building. The Ministry of Natural Resources and Environment manages land administration. The Ministry of Agriculture and Rural Development is in charge of the management of agricultural land use. The Ministry of Finance is in charge of land valuation and real property taxation. In December 2008, the Ministry of Finance transferred the valuation of land allocated to public entities to the Ministry of Natural Resources and Environment.

The underlying concept of land ownership is the foremost determinant of the land policy system in Vietnam. In the absence of private ownership, land is regarded as an asset of the population. Individual members of society as natural or

Table 1: Land ownership in the Constitutions and land laws

<table>
<tr><th>Constitutions</th><th>Land Laws</th></tr>
<tr><td>1946—First Constitution.</td><td rowspan="3">No land law applicable</td></tr>
<tr><td>State ownership, common ownership, collective ownership, organization ownership, household ownership, and individual ownership of land.</td></tr>
<tr><td>1959—Second Constitution.
State ownership and collective ownership.</td></tr>
<tr><td>1980—Third Constitution.
Land ownership by the People. Land allocated without payment. State has the right to recover the land in case of necessity and allocate new land upon demand.</td><td>1988—First Land Law.
Legalizes the allocation of land from cooperatives to households.</td></tr>
<tr><td rowspan="3">1992—Fourth Constitution.
Land ownership by the People. Vietnamese economy develops as a “Market Economy with Socialist Orientation.”</td><td>1993—Second Land Law.
State grants five rights to users of residential and agricultural production land: exchange, transfer, lease, inheritance, and mortgage. Land is recognized as having value and a land price is set by the State to regulate the economic relationship between the State and land users.
State protects land rights by issuing Land Use Right Certificates to land users.</td></tr>
<tr><td>2003—Third Land Law.
State is the representative owner of all land and establishes the legal framework for land by deciding land-use planning, land-use purpose, and land-use holding. State grants to users of land for residential or business purposes the rights to exchange, transfer, lease, donate, inherit, mortgage, guarantee, and use land as capital contributions. Any land recovery or expropriation is compensated by the State.</td></tr>
<tr><td>Amendments to the Third Land Law are currently being considered.</td></tr>
</table>

Sources: Vietnamese constitutions and land laws since independence in 1945

legal entities have only land-use-related rights. Table 1 shows the evolution of land ownership throughout the Constitutions and land laws in Vietnam since independence in 1945.

The 2003 law created new opportunities for private companies to obtain land use rights. In addition to the direct allocation by People's Committees and the transfer of land use rights certificates between legal entities, public auctions are also common. Table 2 illustrates the categories of land users and the progression of their rights through the three land laws. Note that the 1993 land law gave five rights to households, while the 2003 land law granted nine rights to households and enterprises.

These land laws provide only a classification of land users. In fact, land users are not only those who are using land, but also holders of ownership title derived prior to the current legislation. Thus land users include those who purchased land as well as those who have been allocated or granted land from the state. In many cases, users have permanent land use rights, especially residential land and land with communal houses, temples, shrines, etc. In the case of land use rights with a specific length of term, item 1, article 67 of the current land law states:

> At the expiry of the term, the state shall continue to allocate the land to the land users if the land users are still in need of such land and have strictly complied with land legislation during their period of occupancy, and the use of such land is in accordance with the approved land use planning.

Therefore, it is understood that land use rights in Vietnam are a private asset, protected by the civil code. Even if full individual property rights do not exist, there is a legal market for land use rights, which has prompted the Vietnamese

Table 2: Land users and their bundle of rights

<table>
<tr><th rowspan="2">Categories of land users</th><th colspan="3">Bundle of rights</th></tr>
<tr><th>Land law 1988</th><th>Land law 1993</th><th>Land law 2003</th></tr>
<tr><td>1. Organizations</td><td rowspan="8">Legalizing the allocation of land from cooperatives to households</td><td>1. Exchange</td><td>1. Exchange</td></tr>
<tr><td>2. Households, individuals</td><td>2. Transfer</td><td>2. Transfer</td></tr>
<tr><td>3. Communities</td><td>3. Lease</td><td>3. Lease</td></tr>
<tr><td>4. Religious establishments</td><td>4. Inherit</td><td>4. Sub-lease</td></tr>
<tr><td>5. Foreign organizations with diplomatic functions</td><td rowspan="5">5. Mortgage</td><td>5. Inherit</td></tr>
<tr><td>6. Overseas Vietnamese who return to the country to make investments</td><td>6. Donate</td></tr>
<tr><td>7. Foreign organizations and individuals investing in Vietnam</td><td>7. Mortgage</td></tr>
<tr><td></td><td>8. Guarantee</td></tr>
<tr><td></td><td>9. Make capital contribution</td></tr>
<tr><td></td><td colspan="3">Delivering Land Use Rights Certificates (LURCs)</td></tr>
</table>

Sources: Vietnamese Land Laws 1988, 1993, and 2003

government to move towards a market economy and to reform its real property taxation system and align it with international standards.

3. Land-based revenue in Vietnam

Land-based revenue is an important source of funds for the national budget, which until 2000 was dominated almost exclusively by the agricultural land use tax. However, since 2000, revenues from other land-based sources have grown significantly. These sources of revenue include the land use charge, land rent, and the sale of state-owned housing. Table 3 indicates the importance of these land-based revenues for central government.

Within the Vietnamese budget, no distinction is made between real property taxes and other real estate–based revenue. Besides the transfer tax levied when land users sell their land use rights, there are two main forms of land based revenues: single-event sources and recurrent sources. The single-event sources are the land use charge, land rent, and the sale of state-owned houses. The recurrent sources are the agricultural land use tax and the real property tax.

3.1 Land use charge

A land use charge is levied when the state allocates land for use by individuals and organizations. It is also paid when the land use is changed; in particular, when agricultural land changes to a non-agricultural use. The charge is based on land

Table 3: Total land-related and real property revenues in Vietnam (billion VND[1])

Categories	1996	1998	2000	2002	2004	2006	2008
GDP	272,036	361,016	441,646	523,654	715,307	974,266	1,215,287
State budget revenue	62,387	72,965	90,749	131,451	190,928	279,472	323,000
Tax, charges and fees	59,324	69,200	86,867	113,510	121,500	151,682	174,300
Land-based revenue	5,421	5,638	5,533	7,590	20,201	19,935	27,068
Land use charge	1,173	800	1,016	3,244	14,202	13,500	16,500
Land rent	180	382	390	459	846	690	1,569
Registration fees*	1,120	1,016	934	1,332	2,607	3,200	5,194
Tax on land use right transfer	319	355	213	327	640	840	1,974
Sales of state-owned houses	347	822	838	1,120	1,338	1,130	1,051
Agricultural land use tax	1,902	1,956	1,776	772	130	85	82
Real property tax	380	307	366	336	438	490	698
Land-based revenue/GDP	1.99%	1.56%	1.25%	1.45%	2.82%	2.05%	2.23%
Real property tax/GDP	0.14%	0.09%	0.08%	0.06%	0.06%	0.05%	0.06%

* including automobiles, ships, etc.

Source: General Statistics Office and Ministry of Finance, 1996–2008

1. Vietnam dong; 1,000 dong are worth roughly 5 Canadian cents (January 2012).

prices determined by local authorities; however, for those who used land before 15 October 1993, land use rights are granted free of charge.

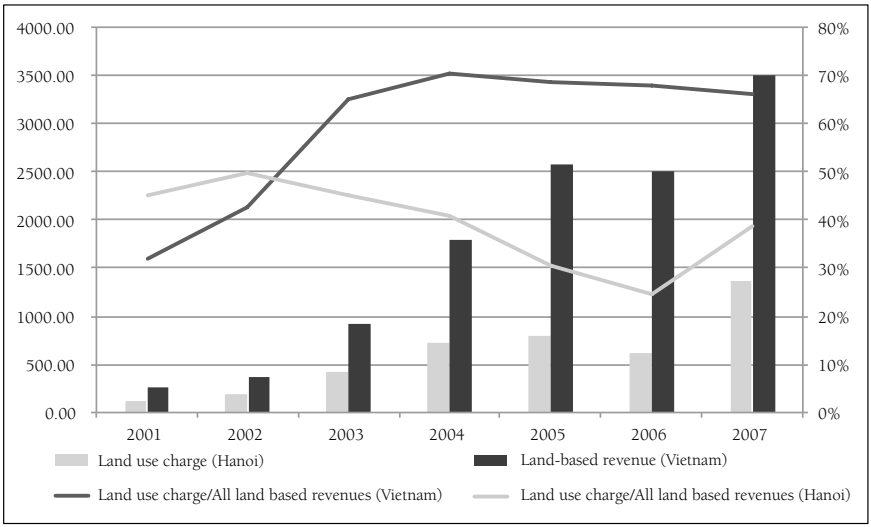
The land use charge is considered income for the state, given that it is the state that is selling its land use rights to natural and legal entities. In 2008, revenue from this source represented 61 percent of all land-based revenue in the national budget. In Hanoi in 2010, the land use charge represented 27.7 percent of fiscal revenue, 11.3 percent of the total municipal budget, and 72.6 of all land-based revenue (Hanoi People's Parliament 2011).

It is important to note, however, that the land use charge is a one-time payment and does not generate ongoing revenues for the national government. It is anticipated that revenue from this source will decline in the future as more land is allocated with land use rights. Figure 1 shows the revenue from land use charge in Vietnam and in Hanoi.

3.2 Land rent

Article 35 of the 2003 Land Law stipulates that land tenants can be individuals, corporations, joint ventures, foreign companies, or foreign diplomatic organizations. Under the law, users of land that is leased for residential, commercial, or other professional activities must pay a land rent. In Hanoi, for 2010 the revenue from land rent represents 3.7 percent of all land-based revenue and 1.4 percent of total fiscal revenue (Hanoi People's Parliament 2011). Table 3 shows the steady increase in land rent revenue from 1996 until 2008 at the national level.

Figure 1: Revenue from land use charge



Source: General Statistics Office and Ministry of Finance, 1996–2008

3.3 Sale of state-owned houses

Before the economic reforms of the late 1980s, Vietnam was a highly centralized regime. The state effectively provided for the needs of its citizens, including their housing. However, the 1993 Land Law recognized that land had a value and subsequent land laws accepted the existence of a real estate market. Therefore, in 1994 the State introduced a program that allowed residents of state-owned housing units to purchase rights in their property. Income from the sale of state-owned houses has grown annually from 1996 and reached 1,338 billion VND in 2004. However, given the finite nature of this resource, revenue has begun to decline, with 1,051 billion VND raised in 2008 (see Table 3). In Hanoi, the sale of state-owned revenue represents 3.35 percent of all land-based revenue and 1.24 percent of total fiscal revenue (Hanoi People's Parliament 2011).

3.4 Tax on the transfer of land use rights

The 1993 land law conceded the existence of a land use rights market. Subsequently, a decree on tax on land use rights transfer was passed in September 1994 and amended in March 1999.[2] This tax was levied on the transfer of land use rights, but not on related improvements. The goal of the law was to limit the change of land use rights ownership. The tax rates were 10 percent for agricultural land use rights transferred and 20 percent for non-agricultural land use rights.

The tax on the transfer of land use rights is essentially a transaction tax rather than a capital gains tax, although the 2003 Land Law (Article 54) states that the tax on the transfer of land use rights should be income taxation. The tax on the transfer of land use rights was changed on 1 January 2009; currently, land use rights transferred by Vietnamese resident households are taxed at 25 percent of capital gains. If there is no capital gain, the tax rate is 2 percent of the transaction value. The tax on the transfer of land use rights that involves a change in land use purposes is based on a land price established by the state.

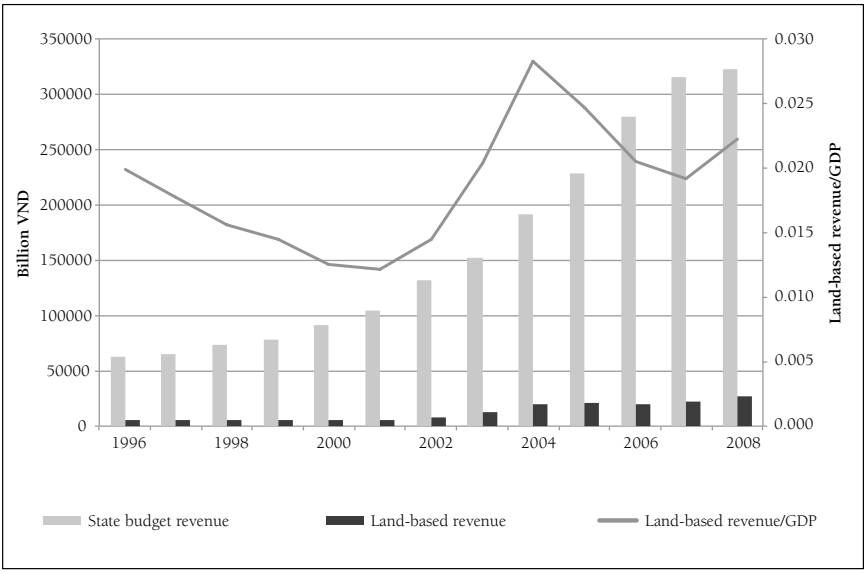
3.5 Fragility in the structure of current land-based revenue sources

In Vietnam, land use charges, land rent, and sale of state-owned houses represent major sources of revenue derived from land. However, they cannot be considered sustainable taxes, because the revenue comes from a one-time transaction when the state allocates land or sells houses. Income derived from these sources tends to be unpredictable, which causes budgetary forecasting issues for central and local governments. Figure 2 demonstrates the comparison of land-based revenue with total state income and the percentage of land-based revenue to GDP.

Looking more closely at the revenue structure, there are some concerns from a fiscal standpoint. As previously noted, land use charges, land rent, and the sales of state-owned housing are single-event revenue sources. Among these three sources, the land use charge represents the most important source of the national government income from land. It accounted for more than 70 percent of all land-based revenue in 2004 and 61 percent in 2008.

2. Decree 144/ND-CP of September 5, 1994, and Decree 17/ND-CP of March 29, 1999.

Figure 2: Share of land-based revenue within central government revenues



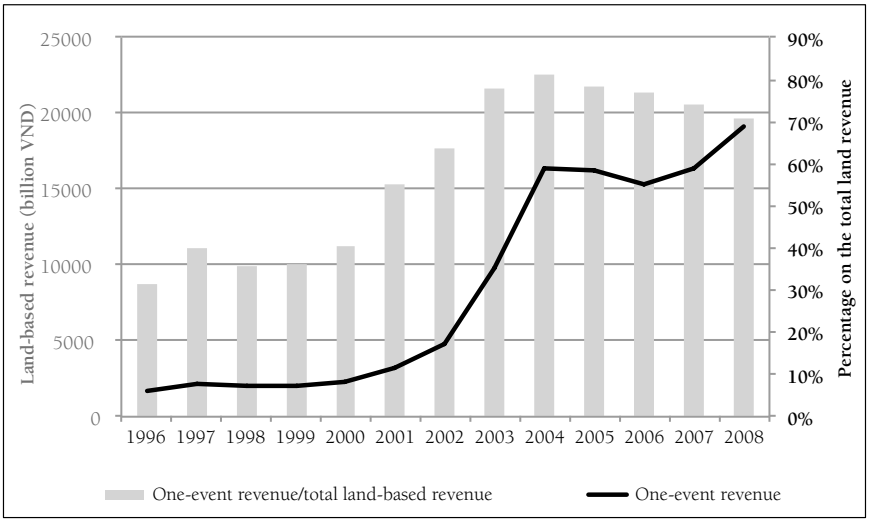
Source: General Statistics Office and Ministry of Finance, 1996-2008

By allocating land to individuals and other organizations, the state is, in effect, selling its property rights to the land users. This is similar to the one-time revenue from the privatization and sale of state-owned enterprises. Because these transactions are irreversible, this revenue source will decline as more land is allocated to the private sector. This reality reveals the fragility of these land-based taxes and charges as illustrated in Figure 3.

The foregoing analysis would suggest that it is imperative to develop sustainable revenue sources that can meet the shortfall in revenue caused by the declining importance of the land use charge. The fact that one-event–based revenue sources contribute 70 percent to total budget revenues suggests an over-reliance on a shrinking revenue base. Other revenue sources need to be considered. The real property tax on land is a possible alternative, but it currently raises only about 2.58 percent of land-based revenue and represents just 0.06 percent of the country's GDP.

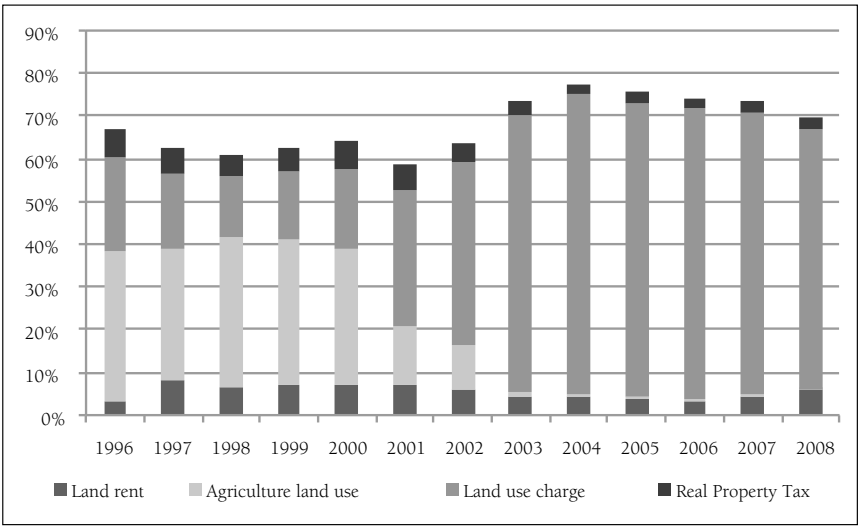
From a budget-forecasting perspective, it is important to develop sustainable income from sources such as annual taxes from agricultural and non-agricultural land uses. The current agricultural land use tax is, in fact, a tax on production based on land size. Moreover, due to exemptions and relief provisions, revenue from this source is declining. An annual tax on non-agricultural land uses combined with the real property tax has significant potential. These taxes require additional consideration in terms of their optimization and potential.

Figure 3: Trends of one-event revenues



Source: Based on data from General Statistics Office and Ministry of Finance

Figure 4: Distribution of revenue from the Real Property Tax and other land-based revenue



Source: Based on data from the General Statistics Office and Ministry of Finance

Figure 4 highlights the imbalance among land-based revenue sources in Vietnam. The income from the annual real property tax on land has declined sharply from 7 percent of all land-based revenues in 1996 to 2.5 percent in 2008. This clearly

represents an unsustainable public finance structure for the government. Recognition of this situation is required to ensure that sustainable land and property-based taxes are turned into future revenue sources.

3.6 Agricultural land use tax

One of the most important land-based revenues in Vietnam is the agricultural land use tax, introduced in July 1993, replacing the previous agricultural tax, which dated from 1983. The tax covers all organizations and individuals using land for agricultural production. Therefore it applies to the use of cultivated land, aquaculture, forests, and economic entities allocated agricultural land.

There are three fundamental components of the tax base: land size, land categories, and tax liability applied to each category. The law stipulates six categories for annual harvest and aquaculture and five for long-term production land (see Table 4). The land classification is based on five physical characteristics: land fertility, location, topography, climatic conditions, and irrigation.

The tax liability is based on the land's productive capacity as measured by the number of kilograms of rice produced per hectare. Provincial and municipal authorities are responsible for determining the price of rice based on the local market prices. This amount cannot be less than 90 percent of the average price.

In line with international trends to reduce the tax burden on agricultural land, Parliament introduced in 2003 (and renewed in 2010) a resolution giving a 100-percent exemption from the agricultural land use tax for the "standard" land unit assigned to agricultural households, poor communes, and agricultural cooperatives.[3] A 50 percent reduction is provided to all other taxpayers. Permanent exemptions are available on agricultural land in mountain locations, maritime areas, and poor regions. These tax reduction and exemption policies have resulted in a sharp decline in agricultural land tax revenues. Figure 5 shows the decline in revenue from the agricultural land use tax on total land based revenue for both Hanoi and Vietnam.

3.7 Real property tax

The real property tax (RPT) was introduced in 1992. Payers of this tax include those who have use rights to non-agricultural land for residential, commercial, and industrial purposes. Despite its name, the tax applies to land only; buildings and other improvements are exempt. The RPT is not an *ad valorem* tax based on an estimate of market value, but rather is related to the productive capacity of the land and its location within an urban area.

The value of location is determined by the application of an adjustment coefficient that reflects the type of urban area (such as main city or secondary city) and then the overall quality of the street that the land fronts. As shown in Table 5, the adjustment coefficients range from 3 to 32 and are related to specific types of urban areas such as cities and then based on street categories and specific location.

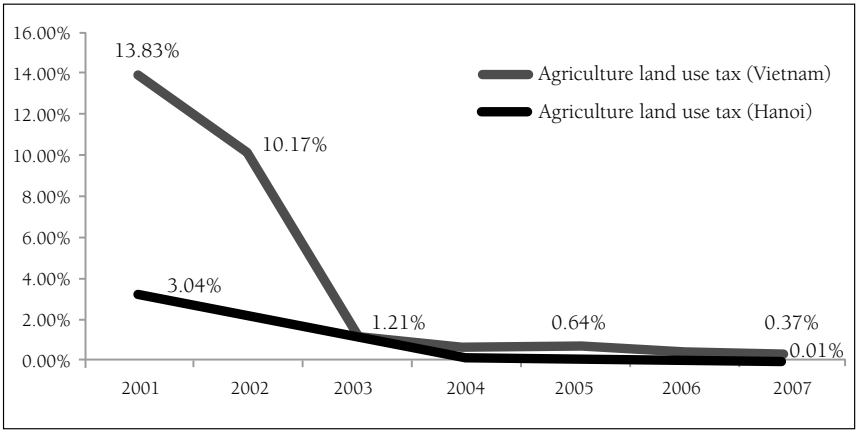
3. Resolution 15/2003/QH11 of June 17, 2003, and Resolution 55/2010/QH12 of November 24, 2010.

Table 4: Agricultural Land Use Tax

Land categories	Land for annual harvest and aquaculture (kg of rice/hectare)	Land for long-term production (kg of rice/hectare)
1	550	650
2	460	550
3	370	400
4	280	200
5	180	80
6	50	

Notes: The annual harvest relates to short-term seasonal agricultural production. Long-term production is related to recurrent crops that do not require replanting annually such as palm oil. There are three fundamental components of the tax base: the land size, the land categories, and tax liability applied to each category. The law stipulates six categories for annual harvest and aquaculture land and five for long-term production land. The land classification is based on five physical characteristics, which include land fertility, location, topography, climatic conditions, and irrigation
Source: Article 8 of Decree 74/CP, October 25, 1993

Figure 5: Revenue from the Agricultural Land Use Tax, as a Percentage of Total Land-based Revenue



Source: General Statistics Office and Ministry of Finance, 1995 – 2009

The first column contains the urban area categories into which all areas in the 731 cities in Vietnam are placed. The "special" category applies to the largest and most important cities, such as Hanoi and Ho Chi Minh City, while the fourth and fifth categories relate to urban areas located in the more remote rural locations.

Each urban area category is further subdivided by four street designations classified by location, revenue generation, and infrastructure quality.[4] Street

4. Decree on Land Pricing 188/ND-CP, November 16, 2004, Article 10

categories are determined by the People's Committee of the province or municipality. Within each street category, land is further sub-divided according to four location factors based on the following criteria:

Location 1—land fronting a street with good vehicular access

Location 2—land fronting a street with average vehicular access

Location 3—land fronting a street with no vehicular access

Location 4—land having extremely limited access

Thus, land located in the special urban-area category in street category 1 and location 1 has an adjustment coefficient of 32, the highest possible. Local tax officials have the responsibility of determining the relevant coefficients based on urban-area and street categories.

The tax rate for the RPT is calculated in a similar manner to the tax on agricultural land use. The calculation process involves multiplying the kilogram of rice per unit land area by the rice price which is then adjusted by the urban area coefficient which ranges from 3 to 32 (see table 5). Table 6 shows how the tax on land and houses is calculated based on the agricultural land use tax.

The tax is calculated according to the following prescribed formula:

$$(550/10{,}000) \times \text{coefficient} \times 4{,}500$$

Where:

- 550 kilograms of rice is produced per hectare (see Table 4);
- the price of the rice is set at 4,500 VND per kilogram;
- the coefficient ranges from 3 to 32, depending on the category and location of the land.

Land found in the best location of the special urban category has an adjustment coefficient of 32. The tax on it is calculated as:

$$(550/10{,}000) \times 32 \times 4{,}500 = 7{,}920 \text{ VND per } m^2$$

Therefore, the real property tax is based on the highest agricultural land category, a situation that effectively ignores the fundamental rules of land value. Agricultural land clearly does not have the same productive capability as non-agricultural land. Commercial and industrial land should be valued using different criteria from those used to value agricultural land.

Because agricultural land categories are determined locally, it is difficult to apply this tax to urban areas. For example, Hanoi is not an optimal rice-producing area, in that the land does not offer appropriate conditions for intensive rice cultivation. As residential and commercial land in Hanoi tends to be the most valuable in the country, assessing commercial, industrial, or residential land use for tax purposes based on rice productivity as opposed to commercial profits from these higher land uses is inappropriate.

A major problem is the link between the tax burden and the price of rice. The law requires the use of the rice price for the year just prior to the tax year, as determined by average prices in the local market. However, the market for rice may

Table 5: Adjustment coefficients based on urban area, street category and location

Urban area categories	Street categories	Coefficients based on Agricultural Land Use Tax			
		Location 1	Location 2	Location 3	Location 4
Special	1	32	28	23	17
	2	30	26	21	14
	3	27	23	18	12
	4	25	21	16	9
Category I	1	30	26	21	14
	2	27	23	18	12
	3	25	21	16	9
	4	22	18	13	8
Category II	1	26	22	17	11
	2	25	21	16	10
	3	23	19	14	8
	4	21	17	12	7
Category III	1	19	17	13	8
	2	18	16	11	7
	3	17	14	9	6
	4	14	11	7	5
Category IV	1	13	11	9	7
	2	12	10	8	6
	3	11	8	7	5
Category V (two street categories)	1	13	11	8	8
	2	11	8	5	3

Source: Ministry of Finance, Part II, Circular 83TC/TCT of October 7, 1994, guiding the execution of Decree 94/CP of August 25, 1994 on Tax on land and buildings

Table 6: Comparison of Agricultural Land Use Tax and Real Property Tax

Tax categories	Tax base	Tax burden calculation	Adjustment
Tax on Agricultural Land Use	Area	Kilogram of rice per area unit x Rice price	Five agricultural land categories
Real Property Tax	Area	Agricultural land use tax x Coefficient x Rice price	Differentiated according to land categories as (i) land classification, (ii) rural or urban area, (iii) location

Source: Law on Agricultural Land Use Tax (1993) and Decree on Land and Houses Tax (1994)

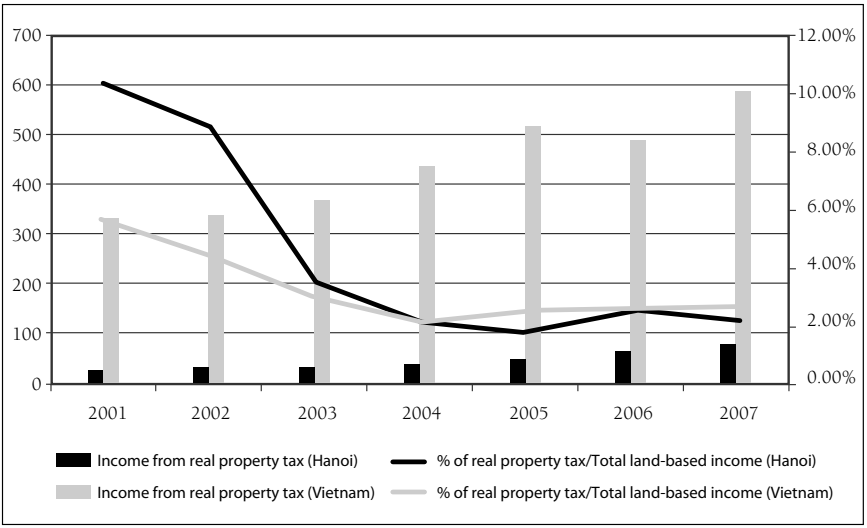
bear no correlation to real property values for non-agricultural land. During 2007 and 2008, for example, real estate prices increased significantly, but the price of rice did not change. The price of rice is not a relevant basis upon which to assess an urban real property tax.

The contribution of this tax to the budget has increased substantially in absolute terms; but has declined sharply in percentage terms. Figure 6 shows the revenue raised in actual and percentage terms at the local level (Hanoi) and at the country level.

4. Property Tax Reform in Vietnam

Momentum within the Vietnamese government is growing for the introduction of an *ad valorem*–based property tax that will promote land use efficiency and satisfy the financial needs of central and local governments (Brzeski and Frenzen 1999; Paugam 1999). Real property is in many ways an obvious choice as a tax base, but one that can be fraught with difficulties (Bahl and Martinez-Vazquez 2007). The choice is essentially whether to adopt a value-based approach or one that is not based on an estimate of property value (Youngman and Malme 1994). Value-based systems have two prerequisites: first, the presence of an active, mature, and transparent real estate market in which there is sufficient transaction evidence upon which to determine objectively the market value of all types of real property; and second, the institutional capacity and capability to provide objective assessments of value.

Figure 6: Revenue from Real Property Tax, in billions of VND



Source: General Statistics Office and Ministry of Finance, 1996-2008

In Vietnam, central and local governments are faced with more responsibilities and increasing budgetary demands as the overall structure of the economy continues to move towards decentralization and privatization. Budget constraints and efficiency in land management are considered priorities. Parliamentary Resolution 27/2008/QH12 recommended the creation of a first law on property tax. The government has expressed interest in converting the current real property tax (land area and rice-based tax on land) to one based on property values. In a report dated July 2009, the Ministry of Finance concluded the necessity of taxing real property.

The government has also identified several beneficial outcomes to a property tax reform process, including enhancing the state's role in land and housing management; the encouragement of legal entities and individuals to use land efficiently; the reduction of land speculation; the development of the real estate market; creating a land registration system and supporting legal framework; and moving towards international standards and practices to facilitate regional and international integration (MOF 2009a, 2009b).

4.1 Challenges to property tax reform

Vietnam is a transitional country undergoing major economic and other structural reforms. Within this overall restructuring process, real property tax reform is an important step to improve the public finance system and provide an environment for fiscal decentralization. A property tax system based on land value could be a bridge between the existing system and an advanced market value-based approach. However, there are challenges and obstacles that Vietnam has to overcome.

First, the definition of land as a natural resource through land legislation has created a misunderstanding that land is a gift of nature. Land belongs to the people; it is collective wealth, therefore it belongs to everyone. Second, there is an incompatibility between the unique form of land ownership (the People's ownership) and the private rights of using land. The State considers land as a natural resource while landowners (legally called land users) consider it real property. Third, the nature of land valuation in Vietnam causes inequities and a lack of transparency, because the official land prices/tariffs are set by the central government and adjusted by municipal or provincial governments based on specific characteristics of local markets. In Vietnamese legislation, these prices/tariffs are referred to as the "market price," but the correlation between the prescribed prices/tariffs is relatively weak. Fourth, the current property-based taxes are considered fragile in terms of their sustainability. These taxes are mainly one-event taxes and are not recurrent forms of property taxation; as a result, revenue from these sources has been declining.

It is often argued that a market value–based system of taxation for real property is the optimal approach to the property tax, as it ensures compliance with the principles of equity and ability to pay. However, there must be processes in place that allow for the capture of value and an active and relatively mature property market within which property rights are freely and actively traded. The

property market in Vietnam could be classified as immature and developing, with only Hanoi and Ho Chi Minh City exhibiting the highest level of market maturity. The 2010 Jones Lang LaSalle Global Real Estate Transparency Index ranked Vietnam at 76 out of 81 countries surveyed. The recording and linking of market prices to land use, location, and the size of the parcel is not yet systematic and transparent, nor is it undertaken by any one organization.

Market value–based taxation of real property requires a sophisticated valuation system that depends upon several key factors. These include a transparent legal system that supports ownership of real property; an official registry identifying parcel limits and the rightful owner of each property; a financial/banking system that supports the funding of property transactions; and a land transfer and sales registration system. In Vietnam, land use certificates and building ownership certificates are a work in progress. Although the legal framework for the real estate market is being developed, a significant number of transactions remain undeclared. Market data at best is scarce and in many places does not exist. The likelihood is that it would take Vietnam several years to implement a market value–based property tax system. Nevertheless, several alternative solutions could be used at least initially to establish a property tax that over time could be developed and possibly mature into one based on market values.

4.2 Area-based property taxes

One of these alternatives is an area-based property tax, which is commonly used to assess property in the absence of a well-developed real estate market (Rao 2008). This method uses the area of land and/or buildings as the taxable base. The value of a building would be based on the number of constructed square metres and the tax liability would then be directly related to the size of the building. The value of the land would be determined in relation to prescribed zonal values per square metre.

According to Bing et al. (2009), "Calculating property tax based on area requires only area measurement, obviating the need for costly collection and analysis of market data and revaluations." Bird and Slack (2004) argue, however, that "Area-based assessment actually involves some adjustment to reflect different characteristics of the property: location, quality of structure, and use of the property… In a unit value system, market value has at least an indirect influence on the assessment base through the application of adjustment factors." According to this argument, a system of adjustment factors can align an area-based assessment with market derived prices. In many respects this methodology supports the way land is currently valued in Vietnam, because the land pricing relies on the following factors:

- Categories of land (rural or urban, in delta or mountain);
- Land use (agricultural or non-agricultural);
- Categories of cities and of streets (based on population and urban infrastructure);

- Location (good vehicle access, medium vehicle access, no vehicle access, extremely limited access).

These factors reflect the market value of real property, because in real estate appraisal practice, about 85 percent of property value is attributed to five characteristics: location; lot dimensions (frontage and depth, or acreage); construction grade; building age (adjusted for additions and renovations); and building area (Isenburg 2007).

For example, several countries in Central and Eastern Europe have implemented new property tax systems based, not on value, but on the size of the property (land and buildings). There is evidence that these area-based systems, while not completely equitable, do work well in transitional economies (McCluskey and Plimmer 2011). Two options based on methodology could be considered.

Option 1

This option consists of combining the unit value of land with the value of buildings. In the absence of an appropriate valuation system, the land prices implemented currently by the central government and adjusted by provincial governments could be used to estimate land values. The building value could be determined by developing a range of coefficients to reflect such factors as age, condition, and use. In effect, this would be a "split tax," whereby the tax on buildings could be different from the tax on land. A combined system based on the market value of land and the area of buildings would provide good coverage of the tax base in that all land and buildings would be included, subject to various exemptions.

One difficultly with this option, at least in the short term, would be the time required to assemble the building inventory. All buildings would need to be inspected and measured to determine the coefficients to be used. This would be a major exercise that would have to be continually updated to reflect new buildings, changes of use, and so on. This option would require two or three years to implement.

Option 2

A simpler approach would be to value the land only. Under this option, the tax liability can be determined by applying a tariff rate to the land area or converting the land area into a proxy land value by using some measure of value and then applying a tax rate to this assessed value.

Parliamentary Resolution 27/2008/QH12 recommended the consideration of a first law on a property tax during 2010. Report 316/BC-UBTVQH12 in April 2010 of the Standing Committee of Parliament explained why a decision was made to temporarily exempt improvements to land in defining the tax base (SCNP 2010). First, the taxing of improvements did not have widespread political support, given the fragility of the economy and the potential adverse effects that the taxing of improvements could have on certain taxpayer groups. Second, real estate speculation is largely driven by escalating land values, as opposed to the value of

improvements. Third, technical and administrative systems have not yet developed sufficiently for the implementation of a tax on improvements. Finally, the taxing of improvements at a time when other elements of wealth are not being taxed has been deemed to be inequitable.

While the land-only method is simpler for governments to administer and for taxpayers to understand, there are some concerns about the land value tariffs or prescribed values in terms of the relationship of these estimates to current market values. The optimal assessment ratio should be 1.0 (that is, 100 percent of market value). A lesser ratio will have direct implications on the revenue generated. Potentially of more importance is the fact that such estimates of land value will remain fixed for at least five years.

In 2010, the National Parliament approved a law (48/2010/QH12) on the taxing of non-agricultural land uses. The act will apply only to residential, industrial, and commercial land. In essence, what has been proposed is an area-based land taxation system. The basis of the tax is simply the land area, multiplied by the land tariff as determined by the municipal or provincial People's Committee. The tax rate applied to this adjusted value is a progressive rate ranging from 0.03 to 0.15 percent for residential property and a flat rate of 0.03 percent for commercial and industrial land. The rationale for these tax rates would appear to be the intention to maintain a degree of equivalence with the average tax liability under the agricultural land use tax. In addition, the progressive rate on residential land has been promulgated in an attempt to reduce land speculation in this sector, while the lower tax rates on commercial and industrial land are intended to promote economic and industrial activity (SCNP, 2010).

The progressivity shown in Table 7 applies only to residential land and excludes industrial and commercial land which is taxed at a flat rate. "Unused" land is the land allocated by the state for projects, but not in use at the assessment date. "Illegal" land is public land being used illegally, although the payment of tax

Table 7: Progressive tax rates on residential land

Tax rate on official land tariffs	Taxable land area
0.03%	Area within standard
	Land used for underground construction or for multiple apartment buildings
0.07%	Area greater than standard but not exceeding 3 times the standard
0.15%	Area exceeding 3 times the standard
	Unused land
	Land use for inappropriate purposes
0.20%	Illegally used land

Source: Law on Non-Agricultural Land Tax of July 7, 2010

Table 8: Number of households and the land standard per household

5 largest cities and 5 lowest land price provinces		Number of households		Residential land standard per household*	
		Rural	Urban	Rural	Urban
Five largest cities	Ho Chi Minh	112,000	632,834	300	150
	Hanoi	170,425	214,301	300	100
	Đà Nẵng	43,338	81,410	250	160
	Hải Phòng	225,512	128,357	200	100
	Cần Thơ	222,400	66,557	300	150
Five provinces of lowest land prices	Quảng Ngãi	169,206	29,318	400	100
	Quảng Trị	61,600	26,160	350	200
	Tuyên Quang	84,800	14,240	450	200
	Lai Châu	57,600	13,038	400	200
	Hà Giang	89,600	16,000	400	200

Source: Ministry of Finance, 2010

does not confer on the user any land use rights. Progressivity is based on the land size—the greater the size of the land holding, the greater the tax rate. The revaluation of the land tariff serving as the tax base is fixed for a five-year period beginning on 1 January 2012.

For residential land, a standard land area has been determined by the municipal or provincial People's Committee. Table 8 shows the variation in the size of the land standard between urban and rural areas and between the wealthiest cities and poorest areas.

4.3 Vietnam's land base

Vietnam is predominantly an agricultural country; 72 percent of the population still lives in rural areas and non-agricultural land represents just over 4 percent of the total land area (see Figures 7 and 8). Therefore from a property tax perspective, the tax base is narrow, as it excludes agricultural land and forests; however, it includes all the high-value urban land in the developing cities.

This section has suggested the direction that possible reform to the property tax could take. The research has indicated two options; however, in reality and given the time frames involved for introduction, a land-only tax would appear to be the only feasible option.

5. Conclusion

The introduction of a market-based ad valorem property tax that includes within the tax base all land and buildings would prove a major challenge for Vietnam, for several reasons. First, the property market has not reached a sufficient level of maturity to provide the necessary transactions upon which to create a value-based

Figure 7: Share of land categories in Vietnam

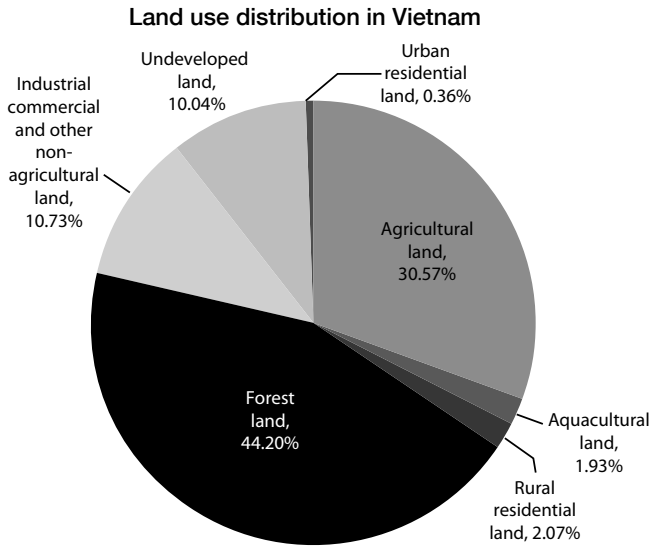
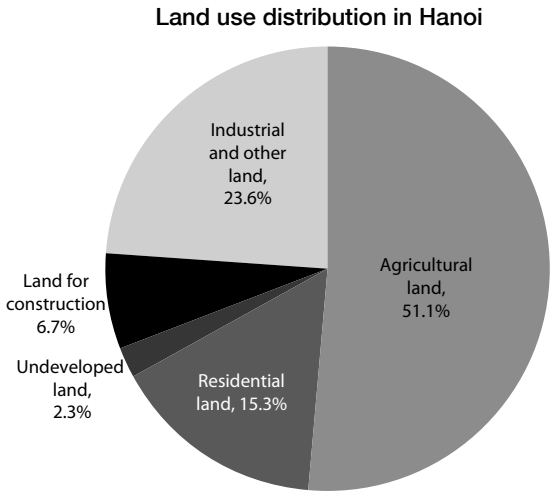


Figure 8: Share of land categories in Hanoi



Sources: Reports of Ministry of Natural Resources and Environment, 2011

property tax. Second, the infrastructure, in terms of a valuation/appraisal profession and associated university programs delivering appropriate real estate courses, has yet to be developed.

Notwithstanding these constraints, there are property tax options that are not based on property values, but rather on the size of land areas and buildings. Comparative exemplars for area-based approaches can be found in several Central and East European countries. Although the government has recognized the need for a locally based property tax, the Parliament in 2010 opted for a land value–based approach. This new land tax will effectively replace the existing real property tax and create a tax base that to some extent reflects prices in the land market.

Abolishing the whole existing system and introducing a new one would not be an ideal solution for Vietnam. Reform is possible with feasible options that could be implemented relatively easily. What is clear is that the approach needs to be simple in its valuation methodology and easy to administer. The land tax would appear to meet these criteria. The complexities of including buildings at least in the initial stage are removed. As the land tax becomes accepted, future reforms could include buildings within the tax base (Trinh and McCluskey 2010).

The land tax has significant potential and, if properly implemented, could increase revenue from 0.06 percent of GDP to 0.14 percent. In comparison with other transition and developing countries, this performance is modest and has room for growth. The tax rates proposed are relatively modest, considering the economic growth Vietnam is experiencing, but they would give policy makers the fiscal space to adjust rates in the future. Although tax rates are set nationally, the largest cities and state committees have direct input into setting the prescribed land tariffs. It is currently unclear as to the actual relationship these land tariffs will have to the market value of land. Given the five-yearly revision cycle, a significant disconnect could emerge between tariffs and market values. The ultimate success of the tax as a revenue generator, particularly for cities, will depend upon efficient administrative processes at the national level and clear and transparent disbursement of revenue to local and city budgets.

Vietnam has made the first steps towards the implementation of a property tax. A well-designed and properly implemented annual tax on the value of land is difficult to evade, so is economically efficient. It is also fair, in that it is a proxy for long-term income, and is roughly correlated to benefits received. As the real estate market matures, the availability and reliability of information on transaction prices improves, and assessors are properly trained in market valuation methods, it will be possible to upgrade the assessment system and move towards taxation based on market value.

Vietnam has to some extent accepted the inevitable: that the store of wealth contained in land provides, in part, a possible solution to the revenue problems faced by its largest and fastest-growing urban areas.

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